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SUBJECT: PERU: 8.0 QUAKE SHAKES ICA ECONOMY

SUMMARY

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**¶1.** The GOP has not yet issued an official assessment of the earthquake's economic effects and it is still early to gauge the disaster's full repercussions. Respected private sector analysts and Embassy officers and contacts have begun to evaluate the economic impacts of the massive August 15 earthquake, above and beyond its considerable human cost, and believe at this early stage that its impact on Peru's economy should be minimal. The actual and potential economic impacts include the following:

-- ICA TRADE DISRUPTION: Heavy traffic and damage to roads and bridges in Ica, including the Pan-American Highway, will clearly affect commerce in the very short term, but recovery should be quick and most industries have already resumed operations;

-- DROP IN TOURISM: Some tourists will likely cancel or postpone travel to Peru in the short-term, although most major sites are hundreds of miles from the impacted area, completely intact and accessible;

-- STOCK MARKET AND INVESTOR CONFIDENCE STABLE: Lima's stock exchange recovered the losses it suffered on August 16 and investor confidence in Peru's economy should hold;

-- CHANCE OF SMALL INFLATION SPIKE: The Central Bank and rating agencies are keeping close tabs on inflation figures, which often rise during recovery efforts;

-- TELEFONICA SUFFERS: Near-monopoly telecom provider Telefonica has emerged with a black eye, as even President Garcia has criticized its poor disaster preparedness for both cellular and land networks;

-- WATER & POWER STILL DOWN: Many Peruvians in the hardest hit areas are still without water, electricity or sanitation services;

-- HIGHWAY DAMAGE: Many coastal roads and highways were damaged, and the Central Highway which connects Lima to the central highlands

is still blocked by rock slides which are stopping the delivery of foodstuffs to the capital.

Some observers have suggested that reconstruction efforts could even accelerate growth and improve pre-existing infrastructure, thus strengthening the longer-term potential of the regional and national economy -- but this will depend on the nature of the follow-up. End Summary.

#### BACKGROUND

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**¶12.** The massive magnitude-8.0 earthquake that struck 25 miles off the central coast of Peru the evening of August 15: killed more than 500 people, injuring a couple thousand more; cut power, water and telecom services; and destroyed homes, roads and bridges. Strong shaking during the 2-minute quake plus numerous aftershocks that still continued five days later were felt by over 10 million people. Lima, 95 miles from the epicenter, survived largely unscathed with few deaths reported, power loss in some neighborhoods, widespread telecom interruption, some damage to office buildings and many homes, and isolated fires. Hardest hit by far was the agro-exporting Department of Ica, along the coast just south of Lima. The department's capital (also called Ica) suffered heavy damages in its historic downtown, as did the smaller coastal cities of Pisco, Chincha and Canete, accounting for most of the casualties.

#### AGROEXPORTING REGION SHOULD RECOVER QUICKLY

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**¶13.** The Department of Ica's economy represents 3.6% of Peru's GDP, and is concentrated in services (58.6%), manufacturing (21.3%) and agriculture (13.7%). Ica, a poster child for Peru's agro and textile export boom, exported \$1.3 billion in 2006 and outperformed most of Peru's departments over the past five years. Respected analyst Macroconsult notes that similar disasters have caused an average 6% drop in a department's GDP with full recovery within a year, and that Ica's recovery in this case should be even quicker given the region's strong economy and the scale of the national and international response.

**¶14.** Although perishable goods like asparagus and avocados could spoil in the short term, and two large textile plants (Textil del Valle and Textil San Cristobal) were temporarily closed, Ica's overall exports aren't expected to drop dramatically. In fact, as of August 17, asparagus harvesting had resumed and most of the largest agroexporters had resumed operations. Textil del Valle hopes to resume operations on August 21, and other plants are already operating part time. The long-term economic damage to the region could be reduced by rapid restoration of electricity, water, communications, roads, and bridges. The vast majority of Peru's exports exit the port of Callao, just north of Lima, so the infrastructure between Ica and Callao is key to international trade.

#### TOURISM TAKES A HIT

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**¶15.** There was significant damage within the coastal Paracas National Reserve according to its manager, including the partial destruction of popular ancient rock formations. The GOP's tourist office notes that the hotel infrastructure in Pisco, Canete and Paracas has suffered considerable damage, causing many hotels to close. For example, the internationally-known Libertadores hotel on the coast of Paracas suffered extensive damage, and its guests were evacuated to Lima. Ica churches also were damaged, including the venerable Senor de Luren church, built in 1558. According to the National Culture Institute (INC), the world famous Nazca lines were unscathed.

**¶16.** Peru's top tourism destinations -- Machu Picchu, the Amazon jungle, the snow-capped Andes, Lake Titicaca, northern beaches -- are located far from the impact zone and suffered no damage. According to the Director General of Civil Aviation, Peru's airports never closed, with international and domestic arrivals and departures continuing as normal. Nevertheless, the massive earthquake will likely cause some tourists to avoid travel to Peru

for some time to come.

#### AFRO-PERUVIANS HIT HARD

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¶7. Chincha, one of the worst-hit districts, has the country's highest concentration of Afro-Peruvians. Hundreds of Afro-Peruvians have lost loved ones, their homes and most of their belongings. U.S. Members of Congress Gregory Meeks and Allyson Schwartz led a visit to this very community on August 7, one week before the earthquake. The Afro-Peruvian organizations have formed a joint assistance committee to collect and deliver assistance to impacted families.

#### CAMISEA AND LNG GAS PROJECTS UNSCATCHED

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¶8. The several-billion-dollar "Camisea" pipeline that brings natural gas and liquids from the jungle to Paracas and Lima suffered no significant damage. The gas fractionation plant on Paracas Bay was stopped momentarily during the quake as part of normal internal emergency procedures, but quickly resumed operations once checks were completed. All pipelines are operating normally.

¶9. The Peru LNG consortium, led by U.S. firm Hunt Oil, is constructing a branch pipeline that will terminate at a new plant on the coast just between Chincha and Canete. Even though this location is at the heart of the impacted area, Hunt Oil Peru GM Carlos del Solar confirmed to us that there were neither human casualties nor significant damage to the construction projects.

#### TELECOM COLLAPSE

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¶10. Cellular and land line communications almost completely shut down the evening of the earthquake, both in the heavy impact areas and in Lima. Those in need of assistance could not contact emergency services and those eager to confirm the well-being of their loved ones were unable to do so. Telephone service was still sporadic the day after the quake. During his radio address the night of the earthquake, President Garcia singled out Telefonica (of Spain), the owner of the majority of the land and cellular phone infrastructure. Garcia complained that since the country is located in an earthquake belt, Telefonica has no excuse for not keeping its systems prepared for tremors. He ordered Transportation and Communication Minister Veronica Zavala to hold emergency meetings with the firms to resolve the problem quickly. The Communications ministry is working hard to ascertain the reasons for the communication failure, so that problems can be corrected. One option under consideration is the installation of a back-up network.

#### WATER & ROADS

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¶11. The main bridge (San Clemente) that connects the region of Lima to the region of Ica collapsed and several other portions of the Pan-American Highway were initially impassable. However, detours along smaller roads were quickly established as the Pan-American Highway was restored. The Central Highway, which leads east into the mountains from Lima, is still blocked by rock slides. One of the main complaints in affected communities was the lack of potable water. Assistance efforts have focused on delivering bottled water to the affected areas as water and sanitation services are still down in the area south of Lima.

#### CENTRAL BANK KEEPING TABS ON INFLATION

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¶12. The Central Bank (BCR) is keeping a particularly close eye on inflation figures, as government reconstruction efforts and the rapid inflow of millions of dollars in international assistance can combine with reduced local availability of certain products to raise prices. BCR President Julio Velarde did note, however, that Peru's 2 percent inflation before the earthquake was quite low and that Peru's strong macroeconomic indicators should help keep inflation in check. He said that President Garcia would not tolerate a return to an inflationary scenario.

STOCK MARKET DIPS, QUICKLY RECOVERS

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¶13. The Lima stock Exchange (BVL) dropped 6.89%, its second biggest drop in 2007, on August 16 (the day after the quake). On August 17, the BVL closed with a gain of 5.58%, its highest increase since May, largely due to improved international markets and metal prices.

Private bank analysts do not expect that the earthquake will rattle investor confidence in Peru's buoyant economy. They note that reconstruction efforts could further foster economic growth, especially through infrastructure, construction and transportation investments. It is possible that the long term economic effect of the disaster will end up being positive rather than negative.

TSUNAMI SCARE BUT FISHING INDUSTRY INTACT

SIPDIS

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¶14. Immediately after the offshore earthquake, a tsunami warning was issued for the Peruvian coast. The warning worked well, as Peruvians throughout the country seemed to get the message quickly (mostly through radio stations). Fishermen scrambled to pull their boats ashore, and panicking residents of low-lying coastal areas tried to get inland by any means possible. Fortunately, the tsunami ended up being less than ten inches high. Peru's fishing industry was unharmed, with even the hardest-hit areas faring surprisingly well. The fish-processing plants, built of strong materials, also survived the disaster well.

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